

## ORGANIZATION AND SUPERVISION

### A. DUTIES AND RESPONSIBILITIES OF DIRECTORS

A bank's board of directors has the overall authority and responsibility for operating the trust department and administering fiduciary accounts, beginning with their acceptance, through their administration, and finally to their closing. In discharging these responsibilities, the board of directors may delegate authority and responsibility to committees of its members, its staff, and/or its legal counsel. However, the board retains ultimate responsibility for all delegated matters and must maintain the proper degree of control and supervision over those to whom it has delegated authority and responsibility. Regarding the trust department and the trust administration, the board of directors can exercise the proper degree of control and supervision by:

- (1) formulating written policies for guidance of department management in its administration of fiduciary matters;
- (2) requiring it be kept informed concerning all trust matters through regular reporting by all committees;
- (3) considering, as a body, important trust matters;
- (4) deciding and approving actions to be taken or which have been taken relative to important trust matters;
- (5) conducting or having conducted a suitable audit of the operation of the trust department;
- (6) providing competent legal counsel to advise trust officers and the trust committee on legal matters pertaining to the administration of the trust department;
- (7) providing for joint custody and control of trust assets; and
- (8) reviewing and responding to the reports of examination of the trust department furnished by supervisory agencies. Only through its written records can the board demonstrate it has exercised its authority and responsibility in a satisfactory manner. Consequently, the minutes of the board should record consideration of and decisions reached with respect to all important matters and reports of all committees.

Where deficiencies or weaknesses exist in the discharge of authority and responsibility by the directors or in the proper recording of their actions, it is the duty of examiners to inform the directors of the importance of correcting deficiencies and to outline the weaknesses together with management's response and planned corrective measures in the report of examination.

### B. TRUST COMMITTEES

The following are certain administrative responsibilities charged to the board of directors which may be delegated to duly appointed committees.

Acceptance of New Accounts - Accounts should be reviewed prior to acceptance in order to evaluate the workability of the instrument provisions, the composition and nature of the assets with any accompanying administrative problems, and the ability of the trust department to adequately provide the fiduciary services required by the trust agreement and nature of the property forming the trust.

Approval of Closed Accounts - Closed accounts should be reviewed to determine that the bank's responsibilities under the instrument have been properly discharged and administration of the account was in accord with the department's policies and procedures. Formal acknowledgment of closed accounts should be noted in board or committee minutes.

Decisions Regarding Discretionary Distributions Extraordinary Expenditures and Like Matters - Discretion is one of the most important powers vested in a fiduciary, and it is believed such powers should be no further removed from the board of directors than its duly appointed committee (i.e., the trust committee or a subcommittee thereof). Approval or ratification of significant discretionary actions should be noted in board or committee minutes.

Supervision of investments - The board of directors or its trust committee is responsible for approval of all purchases and sales of assets and for retention or disposition of investments. When the bank has investment discretion or to the extent that it has such power, it has a twofold responsibility; conservation of the value of the assets entrusted to its care or later acquired, and optimization of income therefrom or growth in value thereof consistent with safety and the terms of the agreement. The latter responsibility is often known as the duty to make trust property productive while the primary responsibility is known as the duty to make trust assets. Investment skill is essential to the realization of these objectives. It is important to remember, although legal responsibility for discretionary

investment authority cannot be delegated to investment professionals, their assistance can be valuable especially when internal investment skill is not adequate for the investment matter involved. The committee and the board would not exercise prudence in retaining, acquiring, or disposing of assets for accounts unless full information concerning the item along with all details of the particular account, are at hand when investment transactions are considered. For further discussion of this topic, refer to Section III(B) of this Manual.

**Account Reviews** - All fiduciary accounts should be reviewed at least once in every twelve-month period and more often as circumstances require. An account review generally should consist of reviewing the administration of the account and the suitability of the accounts assets. Both these segments should be undertaken in light of the governing instrument, applicable laws and regulations, the account's investment objectives, and the needs of the life beneficiaries and remaindermen. Review procedures should provide that the committee have before it a synopsis for each account a record of all assets with individual yields and the amount of principal and income cash on hand. A summary digest prepared by an account officers noting these data may be an effective substitute. Appropriate records should be maintained of the review with the directives of the committee recorded. Ordinarily, minutes of the senior trust committee will record the accounts reviewed either directly or by reference to a subsidiary record where they are detailed. At a minimum, such minutes should acknowledge by reference that accounts have been reviewed by the appropriate committee so the linkage of responsibility for this important function is established to the board or its trust committee.

In directed personal accounts where the bank does not have significant investment discretion, there may be no requirement to review investments, however, a corporate fiduciary may be held accountable for the actions of a co-fiduciary because of the former's "expert" status. Review of directed employee benefit accounts normally would be limited to coverage of administrative matters, however, a cursory review of the investments might be in order to avoid flagrant violation of the Employee Retirement Income Security Act of 1974 (ERISA's) diversification and prohibited transaction

sections.

It is again emphasized that the trust committee must record in its minutes all important matters considered in the performance of any of Me committee's functions. Likewise, it is imperative that the committee make full periodic reports to the board of directors of actions taken.

### C. ORGANIZATIONAL STRUCTURE

The structure and function of the bank's trust department should be prescribed by the bank's bylaws or resolution of the board of directors. Any workable system of organization of the trust department may be acceptable, as long as it is clear that the directors are fully aware of and fulfilling their responsibilities. Discharging fiduciary duties and responsibilities by the board of directors may be accomplished through an organizational plan designed to accommodate the volume and type of business handled, local circumstances, and the growth and development of the bank's fiduciary business. An effectively structured organization is important even in a small trust department. Although the bank's board may elect to review all fiduciary matters, handling routine administrative and operational details is usually designated to others.

Once the organizational structure is understood, the examiner should assess its effectiveness considering the following factors:

- (1) The functional organizational structure should be designed to promote an orderly flow of the trust department's daily work and be sufficiently flexible to accommodate peak workloads without sacrificing efficiency or accuracy. (A table of organization is helpful as a starting point.);
- (2) Trust department committees should be so structured as to constitute flexible, workable entities. Functions and objectives should be clearly defined and effectively executed;
- (3) A plan of personnel organization should provide for continuity and include procedures for recruitment, training, evaluation, and salary administration;
- (4) The staff should be adequate to handle the volume of work. Lines of authority, duties and responsibilities should be clearly defined and

effectively communicated to all personnel in order to promote efficient, productive and orderly execution of department functions. For larger departments, there should be a procedure for obtaining temporary additional help;

(5) The organizational plan should provide an adequate program of internal controls and a system of checks and balances designed to ensure proper administration of the bank's fiduciary business. Such controls should include a procedure for management review of actions taken by all personnel;

(6) The organizational plan should include procedures for effective communication of policies to and between all levels of management. The procedures should facilitate exchange of such information as is necessary to inform supervisory personnel of management policies and directives and apprise senior management of subordinates' activities in implementing policies and directives, thereby promoting the orderly execution of administrative details; and

(7) Authority to take discretionary actions should be expressly defined and communicated to supervisory personnel. Sufficient flexibility should be included to permit expedient action where it would be in the best interest of the customer.

#### **D. MANAGEMENT APPRAISAL**

Management of each department should be judged by the examiner on the basis of its ability to serve those fiduciary accounts presently under administration and those to which the bank has made a commitment. Although a major measure of management's ability is the condition of the trust department and the quality of its fiduciary services, its potential to handle anticipated business is also significant. The depth of planning and the forward-looking attitude of executive officers are relevant factors in making any projection of future management adequacy.

In assessing competence, the qualifications of management should be evaluated in relation to the duties and responsibilities assigned. A trust department manager may have limited knowledge of fiduciary matters yet possess the managerial skills necessary to effectively guide the affairs of a particular trust department. In such cases, the examiner should emphasize the need for fiduciary

expertise at middle management levels. Conversely, in small trust departments management must generally be well versed in all facets of the fiduciary business in which it is engaged. In moderate or larger departments, middle-level personnel may specialize, e.g., investment officers, account administrators, operations officers, taxation specialists, or new business development officers. Each should have a level of competence commensurate with the department's activity and business sophistication.

The examiner should analyze the type and depth of training offered and formulate an opinion as to the quality of the program. Training may include in-house development programs, on-the-job training, correspondence courses, banking schools and seminars, facilities of larger banks, and tuition aid programs. The examiner should also consider expertise available from sources outside the bank. Management may compensate for "in-house" weaknesses such as investments, tax law, or accounting by employing outside professional services. In such instances, the examiner should evaluate management's capacity to utilize these services effectively.

When serious shortcomings or significant criticisms exist, the competence of management should be questioned. When deficiencies are of short duration, often middle management in the specified area may be responsible; when deficiencies are longstanding or widespread, top management becomes suspect. The examiner-in-charge must detail deficiencies in management and make such recommendations as are appropriate to effect corrective action.

#### **E. TRUST POLICIES**

It is the policy of the FDIC that directors formulate suitable trust department policies and implement sufficient practices and controls to promote high quality fiduciary administration. When properly monitored by directors, well-developed policies, practices and controls promote operating efficiency, compliance with laws and sound fiduciary principles, and deter losses through surcharge or charge-off. Policies should be written and formulated to provide a clear framework within which trust officers must operate and administer all aspects of the bank's fiduciary business. Some of the more important areas of policy consideration are:

**Investments** - Quality of investments should be maintained by setting appropriate standards to prohibit speculation, promote preservation of principal and diversification of portfolios, optimize income, and fulfill corporate responsibilities imposed by fiduciary standards. Guidelines should be developed to provide for prompt investment of income and principal cash unless the governing instrument, local law, or parties properly authorized to direct investments provide otherwise. Policies may call for the utilization of a "buy/sell" approved list of securities. Guidelines should be included for the handling of any special types of investments (e.g., closely held businesses, options, or mineral properties) held by the department.

**Use of Material Inside Information - "Chinese Wall"** - The board should institute appropriate policies and procedures to prohibit improper use of material inside information in making investment decisions or recommendations.

**Self-Dealing, Conflicts of Interest** - The most fundamental duty of a fiduciary is that of undivided loyalty to the beneficiaries and other parties-in-interest. Policies should be established to cover such areas as investment in own-bank stock, deposits with own bank purchase of assets from or sales to directors, officers, employees and their interests, bank affiliates, or between trust accounts. Specific consideration should be given those areas where the interests of the fiduciary account might conflict with those of the commercial banking department. Even potentially questionable transactions should be avoided if practical.

**Personnel** - Policy should cover the size of the trust department staff, qualifications of personnel, organizational structure, employee ethics, salary administration and employee benefits. A code & ethical standards should deal with such matters as: acceptance of gratuities, favors and bequests from fiduciaries, customers or agents; disposition of fees earned by employees for personal services rendered in the performance of fiduciary duties; employees accepting benefits for serving as co-fiduciary with the bank; employees exerting influence on fiduciary customers for personal gain; and employees maintaining confidentiality of the bank's fiduciary relationships.

**Business Development** - The type of fiduciary business to be solicited should be specified to

enable management to maintain sufficient capability and expertise in administering current fiduciary business and anticipating future growth.

**Profitability** - Stockholders of a bank operating a trust department are entitled to expect a reasonable return on their investment. This requires profit motivation from the board of directors and establishment of equitable fees that will cover costs and provide a reasonable return to the bank. Policies should include the bank's position on discounting of fees through fee concession and compensating balances, and the method by which the trust department may be compensated by the bank for such discounts. If there is a policy of allowing reduced fees to directors, officers, employees, shareholders, or their interests, it should be in writing and approved by the board.

**Other Trust Policies** - Other trust policy subjects should include acceptance of accounts, acceptance of co-fiduciaries appointments and division of compensation with co-fiduciaries, operations and administration, account reviews, overdrafts, loans to trust accounts, brokerage placement policies, and securities trading. A periodically updated fee schedule is often handled as a policy item.

## F. LEGAL COUNSEL

Because legal questions frequently arise in connection with fiduciary relationships, it is essential that a bank have available the services of a competent counsel for consultation on fiduciary matters. The ability of officers and directors to discern instances in which legal assistance will be necessary in order to avoid embarrassment and possible surcharge is an important factor in the successful operation of a trust department. Frequently, accounts being considered for acceptance should be referred to counsel for opinion and recommendations.

## G. MEETING WITH DIRECTORS AND COMMITTEES

At the conclusion of each examination, the trust examiner-in-charge should meet with the chief executive officer of the bank, the trust department manager and the auditor, or their counterparts. Although review of trust committee minutes and

supplemental reports should indicate the degree of involvement and interest of committee members in their assigned duties and responsibilities, it may not provide sufficient basis for analyzing committee effectiveness. Therefore, examiners may consider attending committee meetings held during the examination, not only to observe but also to share examination findings and offer recommendations to the committee. The examiner may use this opportunity to inquire of committee members their collective views on the department, its direction and potential. If the trust department is assigned or likely to be assigned a composite "4" or "5" rating under the Uniform Interagency Trust Rating System (UITRS), the examiner-in-charge should meet with the board of directors or appropriate committee at the conclusion of the examination. If the trust and commercial departments of the bank are examined concurrently, the meetings may be consolidated, but in any event, there should be close coordination between the examiners-in-charge. The examiner-in-charge may attend a board of directors meeting at other times if conditions warrant.

When it is concluded a meeting with a board committee rather than the full board is appropriate, selection of the committee must be based on the group's actual responsibilities and functions rather than its title. In all cases, the committee chosen should include an acceptable representation of board members who are not full time officers. (Such meeting may be waived for trust departments assigned or to be assigned a composite rating of "1", "2" or "3".) If the board or appropriate committee does not hold a regular meeting near the completion of the examination, the examiner should call a meeting or subsequently return to the bank to meet with them. The purpose of such a meeting is to acquaint directors and/or committee members with the condition of the trust department, present recommendations for correcting deficiencies or weaknesses, and seek agreement on how problems are to be corrected. In any event, the examiner should note in the Examiner's Comments and Conclusions schedule of the report of examination with whom the findings of the report were discussed and their corrective commitments and/or reactions.

#### **H. STATEMENT OF PRINCIPLES OF TRUST DEPARTMENT MANAGEMENT**

The Corporation, in recognition of the necessity for establishing guidelines for the sound operation of a trust department, issued a "Statement of Principles of Trust Department Management" which is set forth on page six of this Section. Where the bank has not done so, the examiner should recommend that the board of directors formally adopt the minimum standards. It is expected that trust departments under examination meet the minimum requirements outlined therein and examining personnel should ascertain that trust management is operating the department in a manner consistent with the Statement. In ascertaining if a bank is in conformance with these minimum standards, examiners must use judgement. The Statement is general in scope and permits latitude in implementation, however, the examiner must determine whether or not the bank conforms to the spirit of the requirements set forth. Where deficiencies are noted, trust management should be apprised of the areas needing correction. A bank's attitude toward effecting corrective action should be reflected in the report of examination.

**STATEMENT OF PRINCIPLES OF TRUST DEPARTMENT MANAGEMENT**

The minimum requirements for sound banking practices in the operation of a Trust Department, and as safeguards for the protection of depositors, fiduciary beneficiaries, creditors, stockholders and the public, should include:

1. Operation of the Trust Department separate and apart from every other department of the bank, with trust assets separated from other assets owned by the bank and the assets of each trust account separated from the assets of every other trust account; and
2. Maintenance of a separate set of books and records for the Trust Department in sufficient detail to properly show all Trust Department activities.

The board of directors should, by proper resolution include in its minutes:

1. Designate an officer, qualified and competent, to be responsible for and administer the activities of the Trust Department, and define his duties;
2. Name a trust committee consisting of at least three directors, at least one of whom shall not be an officer of the bank, to be responsible for and supervise the activities of the Trust Department;

The trust committee should:

- (a) Meet at least once every month;
  - (b) Review the assets of each trust account at least once during each period of twelve months;
  - (c) Approve all purchases, sales and changes of trust assets;
  - (d) Approve the opening of all new trust accounts;
  - (e) Approve the closing of trust accounts;
  - (f) Keep full minutes of its actions, including its actions on matters included in (a) through (e) above;
  - (g) Make periodic reports to the board of its actions.
3. Provide competent legal counsel to advise the trust officers and the trust committee on legal matters pertaining to the administration of the Trust Department;
  4. Provide for joint custody of trust assets under at least two or more officers and employees;
  5. Receive the report of the trust committee and record its actions thereon in its minutes;
  6. Make or cause to be made an annual audit of the Trust Department at least once during each period of twelve months and, where possible and practical, provide for internal controls over the Trust Department; and
  7. Review the examination reports of the Trust Department by Supervisory Agencies and record its action thereon in its minutes.

Nothing herein is intended to prohibit the board of directors from acting as the trust committee, from designating additional officers to administer the operations of the Trust Department and defining their

**duties, or from appointing additional committees for the Trust Department operation and defining the duties of such committees.**